89-809

NO. _____

In The

Supreme Court Of The United States

OCTOBER TERM, 1989

PAINEWEBBER, INC.,
KENNARD L. GEORGE and
DEAN MCGOWAN,

Petitioners,

vs.

NANCY C. FRYE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Should a party to an arbitration agreement be denied its contractual rights merely because it did not file a motion to compel arbitration before this Court decided *Dean Witter Reynolds Inc. v. Byrd*, 270 U.S. 213 (1985), at a time when such a motion would have been utterly futile?

RULE 28.1 LIST

PaineWebber Incorporated is a wholly owned subsidiary of PaineWebber Group Inc. PaineWebber, Inc. and PaineWebber Group Inc. have subsidiaries and affiliates as follows:

Entity

A. **Subsidiaries of PaineWebber Group Inc.**

PaineWebber Incorporated
PaineWebber International Inc.
Mitchell Hutchins Asset Management Inc.
Paine Webber Real Estate Securities Inc.
First Income Properties, Inc.
Second Income Properties, Inc.
Third Income Properties, Inc.
Fourth Income Properties, Inc.
Fifth Income Properties, Inc.
Sixth Income Properties, Inc.
First Qualified Properties, Inc.
Second Qualified Properties, Inc.
Third Qualified Properties, Inc.
Fourth Qualified Properties, Inc.
First PW Growth Properties, Inc.
Second PW Growth Properties, Inc.
First IRB Properties, Inc.
PW Shelter Fund Inc.
Third PW Growth Properties, Inc.
First Equity Partners, Inc.
Fifth Mortgage Partners, Inc.
Fourth Development Fund, Inc.
First PW/Crow Properties, Inc.
PW Franklin Corporation
PW Fremont Corporation
Maiden Lane Leasing Corp.
PaineWebber Leasing Corporation
PaineWebber Venture Management
PaineWebber Capital Inc.

Entity

PaineWebber Trading Inc.
PaineWebber Programmed Amortization Term Securities, Inc.
PaineWebber Mortgage Finance Holding Corp.
PaineWebber Futures Management Corp.
PWEQ Corporation
Harborview Corporation
Westside Funding Corporation
PaineWebber Mortgage Acceptance Corporation I
Fourth Development Fund Inc.

B. **Subsidiaries of PaineWebber Incorporated**

Blyth Eastman Paine Webber Servicing Inc.
Blyth Eastman Paine Webber Health Care Funding Inc.
PaineWebber Properties Incorporated
PaineWebber Realty Investments, Incorporated
Blyth Eastman Paine Webber International S.A. (Panama)
Paine Webber Incorporated of Puerto Rico
Paine, Webber, Jackson & Curtis Limited
PWJC Insurance Sales Incorporated
PaineWebber Chairman's, Inc.
Paineweb Nominees Inc.
BEPWI Sub., Inc.
Rotan Mosle Financial Corp.
PW Production Inc.
PW Energy Inc.
PaineWebber Far East Limited
Abacus Fund Securities Corporation
BEDCO Leasing Company, Inc.
BEDCO Insurance Agency of Ohio, Incorporated
PWJC Insurance Agency of Puerto Rico, Inc.
Wall Street Realty Corporation
Bedco Overseas Corporation (Puerto Rico)

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NO. _____

In The

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PAINEWEBBER, INC.,
KENNARD L. GEORGE and
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vs.

NANCY C. FRYE,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners PaineWebber, Inc. ("PaineWebber"), Kennard L. George ("George"), and Dean McGowan ("McGowan"), defendants below, respectfully pray that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Fifth Circuit, entered on July 18, 1989, and the Fifth Circuit's decision of August 15, 1989, which reversed an Order of the United States District Court for the Northern District of Texas, entered on October 14, 1987.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 877 F.2d 396, and is reproduced at Appendix B. The opinions of the United States District Court for the Northern District of Texas are reproduced at Appendices D and E.

JURISDICTION

The opinion of the Court of Appeals was entered on July 18, 1989. The PaineWebber defendants' Motion for Rehearing was denied on August 15, 1989. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and Supreme Court Rule 17.1.

STATEMENT OF THE CASE

In the summer of 1982, Plaintiff-Respondent Nancy Frye ("Frye") opened a securities account with the Paine Webber Jackson & Curtis, Inc. ("PaineWebber") office in Dallas, Texas. Frye signed a Customer's Agreement, in part, obligating her to submit any dispute with PaineWebber to arbitration. During her relationship with PaineWebber, Frye dealt with account executive Ken George and PaineWebber branch manager Dean McGowan ("McGowan"). Subsequently, on June 16, 1983, Respondent Frye brought suit in the United States District Court for the Northern District of Texas, Dallas Division, against PaineWebber, McGowan, George (hereinafter collectively "PaineWebber") and Gary Bassett[1], alleging federal securities violations and pendent state law claims. The District Court properly had jurisdiction over all Frye's claims.

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[1]The trial court stayed Frye's claims against Bassett, and they were not part of the appeal to the Fifth Circuit.

The suit was brought at a time when the intertwining doctrine was the prevailing law of the Fifth Circuit. The intertwining doctrine held that where federal and state claims were intertwined, no claims could be arbitrated. *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 334-36 (5th Cir. 1981). Any attempt by the PaineWebber defendants to compel arbitration would therefore have been futile in the face of that doctrine. The case proceeded to trial before the Honorable William M. Taylor in February 1985. After two weeks of testimony, Judge Taylor granted the PaineWebber defendants' Motion for Directed Verdict. Judge Taylor subsequently declared a mistrial, and the case was assigned to the Honorable A. Joe Fish. On March 4, 1985, this Court decided *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985), in which this Court rejected the intertwining doctrine, previously the law in the Fifth Circuit, and held that pendent state law claims brought in a securities action are arbitrable. Immediately afterwards, on April 3, 1985, the PaineWebber defendants demanded arbitration based on *Byrd*. After this Court's decision in *Byrd*, PaineWebber did not participate in discovery, amend its pleadings, or otherwise act inconsistently with its right to arbitrate. Subsequently, the PaineWebber defendants filed their motion to compel arbitration in the district court, which Respondent Frye opposed. The trial court granted PaineWebber's motion to compel arbitration and ordered the parties to arbitrate their claims. In granting that motion, the district court correctly ruled that any attempt to compel arbitration of Respondent Frye's claims prior to *Byrd* would have been futile and that PaineWebber had promptly moved for arbitration after *Byrd*.

In March, 1987, during the pendency of this case in arbitration, this Court decided *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987), holding that claims under

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), were arbitrable. Under *Byrd* and *McMahon*, then, *all* claims Frye asserted were properly arbitrable, and the parties were at the time in the proper forum — before a panel of arbitrators.

On April 27, 1987, after hearing all the evidence, a panel of arbitrators for the National Association of Securities Dealers, Inc., ("NASD") dismissed Frye's claims in their entirety. The trial court confirmed the arbitrators' decision by judgment dated October 14, 1987, and thereby dismissed Frye's claims against Petitioners. Frye appealed the district court's judgment dismissing her claims.

The Fifth Circuit, in reversing the trial court's decision to compel arbitration, held that this Court's intervening decisions in *Byrd* and *McMahon* did not justify arbitration of Frye's claims. In doing so, the Fifth Circuit refused to follow the clear mandate expressed by Congress and this Court, to enforce arbitration agreements.

REASONS FOR GRANTING THE WRIT

Introduction

The Fifth Circuit's determination that the right to arbitrate had been waived due to PaineWebber's pre-*Byrd* participation in discovery and trial is in direct conflict with the decisions of the Eleventh Circuit in *Benoay v. Prudential-Bache Securities, Inc.*, 805 F.2d 1437, 1440 (11th Cir. 1986), the First Circuit in *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 806 F.2d 291, 294 n.3 (1st Cir. 1986), the Ninth Circuit in *Conover v. Dean Witter Reynolds, Inc.*, 837 F.2d 867, 868 (9th Cir. 1988), the Eighth Circuit in *Nesslage v. York Securities, Inc.*, 823 F.2d 231, 234 (8th Cir. 1987), the District Court for the Northern District of Illinois in

Kayne v. Paine Webber, Inc., 684 F.Supp. 978, 982 (N.D. Ill., E.D. 1988) (residing in the Seventh Circuit), and the Second Circuit in *Rush v. Oppenheimer & Co.*, 779 F.2d 885, 889-91 (2nd Cir. 1985). The decisions from these Circuits have held that any motion to compel arbitration prior to *Byrd* would have been futile, and, therefore, any delay or participation in discovery or trial prior to *Byrd* did not constitute waiver of a party's right to arbitrate.

The Fifth Circuit's finding of waiver also conflicts with recent decisions of this Court and with Congress' clear mandate in the Arbitration Act, both of which establish the strong federal policy favoring arbitration, such that all doubts are to be resolved in favor of arbitration. *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983). Unless this issue is resolved, the parties to pre-*Byrd* arbitration agreements will continue to be deprived of their contractual rights to an efficient, expeditious and less expensive alternative to the federal courts for settling their disputes.[2] Meanwhile, the lower federal courts will continue to be burdened by lawsuits over claims which should, since this Court's decisions in *Byrd* and *McMahon*, be arbitrated.

Furthermore, the issue at hand will continue to be present in the lower courts unless this Court resolves the conflict in the Circuits. This Court's decisions in *McMahon* (upholding agreements to arbitrate claims raised under the Securities Exchange Act of 1934), and *Rodriquez de Quijas v. Shearson/American Express, Inc.*, ___ U.S. ___ , 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989) (holding that agreements to arbitrate claims under the Securities Act of 1933 are enforceable), will

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[2]Frye's claims in this case have already been considered and dismissed by a panel of arbitrators. Inequity will result if PaineWebber is required to fight a battle previously won in arbitration, once again, in a trial court.

generate the same issues, regarding waiver of a previously non-existent right to arbitrate, as are presented in this case. *See e.g., Brown v. Dean Witter Reynolds, Inc.*, 882 F.2d 481 (11th Cir. 1989). If the Court fails to resolve the conflict in the Circuits concerning this waiver issue, costly and unnecessary litigation in the lower federal courts over the same issue will continue for years to come.

I.

THE FIFTH CIRCUIT IS IN DIRECT CONFLICT WITH FIVE OTHER CIRCUITS IN HOLDING THAT THE PRESENCE OF THE INTERTWINING DOCTRINE AS AN ESTABLISHED PRECEDENT WAS NOT JUSTIFICATION FOR DELAY IN SEEKING ARBITRATION PRIOR TO THIS COURT'S DECISION IN *DEAN WITTER REYNOLDS, INC. V. BYRD*

A. FIVE CIRCUITS HAVE HELD THAT ARBITRATION IS NOT WAIVED WHERE THE SUBSTANTIVE CLAIMS WERE NOT ARBITRABLE BEFORE *BYRD*.

The First, Second, Eighth, Ninth and Eleventh Circuits[3] are all in direct conflict with the Fifth Circuit on the issue of waiver *vel non* of the right to arbitration. The position of these Circuits is summarized in *Benoay v. Prudential-Bache Securities Inc.*, 805 F.2d at 1440. In *Benoay*, the Eleventh Circuit held that there had been *no waiver* of the right to arbitrate, although the motion to compel arbitration had been made two and one-half years after initiation of the suit. In reaching that conclusion, the court held that

[3]The U.S. District Court for the Northern District of Illinois, residing in the Seventh Circuit, is also in direct conflict with the Fifth Circuit's opinion in *Frye*. *See Kayne v. Paine Webber, Inc.*, 684 F.Supp. at 982. Because *Kayne* has not been overruled by the Seventh Circuit, it must be presumed to be the prevailing law of that Circuit.

the motion had been "timely in light of a change in law affecting the party's rights." *Id.* The court made the following observations.

> At the time this suit was commenced, the law of this Circuit prohibited arbitration of otherwise arbitrable state claims when arbitrable and nonarbitrable claims were "inextricably intertwined". (Citations omitted.) Thus, until the Supreme Court handed down its decision in *Byrd* (citation omitted), [Defendants] could not have obtained an order compelling arbitration. As the court in *Miller* acknowledged, "this Circuit does not require a litigant to engage in futile gestures merely to avoid a claim of waiver." [citing *Miller v. Drexel Burnham Lambert Inc.*, 791 F.2d 850, 854 (11th Cir. 1986)]
>
> In *Byrd*, the Supreme Court rejected the intertwining doctrine and ruled that "the Arbitration Act requires district courts to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel, even where the result files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums." (Citation omitted.) Therefore, *any right to arbitrate the state law claims which [Defendants] acquired did not accrue until March 4, 1985* — the day *Byrd* was decided. (Citations omitted.) Thus, [Defendants'] motion to compel arbitration was made approximately 10 weeks after their right to arbitrate accrued. . . . Accordingly, we find no waiver of the right to arbitrate.

Benoay, 805 F.2d at 1440. (emphasis added).

The conclusion the Eleventh Circuit reached in *Benoay* follows from these premises: (1) there is a strong federal policy in favor of arbitration; (2) a pre-*Byrd* motion to compel arbitration of pendent state claims would have been

futile given the presence of the intertwining doctrine; and (3) courts should not require litigants to engage in futile gestures merely to avoid subsequent claims of waiver.

The Ninth Circuit, Eighth Circuit, Second Circuit and First Circuit have embraced the *Benoay* reasoning. *See Conover*, 837 F.2d at 868 (9th Cir. 1988) (two year delay in seeking arbitration not waiver because claims considered non-arbitrable prior to *Byrd*); *Letizia v. Prudential-Bache Securities Inc.*, 802 F.2d 1185, 1187 (9th Cir. 1986) (due to intertwining doctrine there was no right to arbitrate when suit was filed, thus, no subsequent waiver); *Fisher v. A. G. Becker Paribas Inc.*, 791 F.2d 691, 693 (9th Cir. 1986) (party entitled to rely on assumption that intertwining doctrine prevented arbitration, thus, no waiver due to delay); *Nesslage*, 823 F.2d at 234 (8th Cir.) (two year delay in seeking arbitration did not result in waiver where motion to compel was filed soon after *Byrd*); *Rush*, 779 F.2d at 889-91 (2nd Cir.) (Court partially relied on unavailability of arbitration prior to Byrd in finding no waiver);[4] *Page*, 806 F.2d at 294 (1st Cir.) (defendants motion to compel arbitration was timely in light of perceived change in the law after *Byrd*).

B. THE FIFTH CIRCUIT HAS HELD THAT DELAY IN SEEKING ARBITRATION BASED UPON THE PRESENCE OF THE INTERTWINING DOCTRINE LATER REJECTED IN *BYRD* IS NOT JUSTIFIED AND RESULTS IN WAIVER OF ANY RIGHT TO COMPEL ARBITRATION.

The Fifth Circuit has rejected PaineWebber's contentions that any attempt on their part to compel arbitration prior to this Court's decisions in *Byrd* and *McMahon* would have

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[4]*See Ilan v. Shearson/American Express, Inc.*, 632 F.Supp. 886, 890 (S.D.N.Y. 1985).

been futile. *See Frye*, 877 F.2d at 398-99. Thus, the Fifth Circuit has essentially held that PaineWebber waived its right to arbitrate by failing to assert that right, when the mere assertion itself would probably have subjected PaineWebber to sanctions under F.R.C.P. 11. *Id.*[5] Under the correct view, however, PaineWebber's right to arbitrate "did not accrue until March 4, 1985 — the day *Byrd* was decided." *Benoay*, 805 F.2d at 1440. Consequently, under the reasoning of five other Circuits, PaineWebber's demand for arbitration on April 3, 1985, came immediately after the right accrued and, therefore, was timely.[6] The inconsistencies created by the conflict in the Circuits are clear.

In reaching its conclusions below, the Fifth Circuit ignored the law of the other Circuits and relied almost exclusively on its own precedent. The court pointed out the contrary authority in the other Circuits but refused to follow that authority. The conflict among the Circuits on the issues presented in this case was, as a result, made very clear by the Fifth Circuit's opinion in *Frye*.

In *Byrd*, this Court recognized that the Fifth, Ninth and Eleventh Circuits had relied upon the intertwining doctrine. *Byrd*, 470 U.S. at 216-17. Of those three Circuits, the Ninth and Eleventh have *refused to find waiver* of the right to arbitrate based upon pre-*Byrd* delay. The Fifth Circuit, on the other hand, has taken the opposite position in this case. The Fifth Circuit puts litigants in an intolerable position, because Petitioners are held to have forfeited a right they did not have until March 4, 1985.

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[5]*See infra* p. 10 (quote from *Ilan*, 632 F.Supp. at 890, suggesting that a pre-*Byrd* motion to compel would have resulted in sanctions.).

[6]The general rule is that absent injustice an appellate court should apply the case law in effect at the time it renders its decision. *St. Francis College v. Al-Khazraji*, 481 U.S. 604, 608 (1987).

If PaineWebber had sought arbitration prior to *Byrd*, the Fifth Circuit would have refused to compel based upon a violation of the intertwining doctrine. If PaineWebber had waited until after *Byrd* to seek arbitration, as they did, they would be denied arbitration based upon their alleged waiver. The laws of this Court cannot support such a result.

PaineWebber's plight may be summarized by reference to the District Court's opinion in *Ilan*, 632 F.Supp. at 890. The court concluded:

> [D]efendants have correctly suggested that it would have been futile for them to make a motion to compel arbitration when this action was commenced. Indeed, the *motion would have been denied and sanctions may well have been imposed.* However, once *Byrd* was decided, there were new and legitimate grounds to argue that [Plaintiff's] claims were arbitrable . . .

Id. (emphasis added).

II.

THE FIFTH CIRCUIT'S DECISION BELOW CONFLICTS WITH CONGRESS' MANDATE, AND THIS COURT'S HOLDINGS, BY FAILING TO GIVE EFFECT TO THE STRONG FEDERAL POLICY FAVORING ARBITRATION

It is undisputable that this Court and Congress have established a strong federal policy in favor of arbitration. Congressional policy regarding arbitration is codified in the Arbitration Act which states in pertinent part that:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, . . . *shall be valid, irrevocable, and enforceable,* save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (1982) (emphasis added). Congress intended the Arbitration Act to reverse the courts' general hostility towards arbitration agreements and to expressly state the strong public policy in favor of enforcing such agreements. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625-26 (1985); *Byrd*, 470 U.S. at 219-20 & n. 6; *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983).

Consistent with this view, it has been noted that the "waiver of a contractual right to arbitration is not favored." *Fisher*, 791 F.2d at 694. Because waiver of the right to arbitration is disfavored, "any party arguing waiver of arbitration bears a heavy burden of proof." *Belke v. Merrill Lynch Pierce Fenner & Smith*, 693 F.2d 1023, 1025 (11th Cir. 1982). Consequently, "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of *waiver*, delay, or a like defense to arbitrability." *Moses H. Cone Memorial Hospital*, 460 U.S. at 24-25 (emphasis added).

The Fifth Circuit's decision in this case fails to comply with the mandate favoring arbitration expressed by this Court and Congress. Although the Fifth Circuit alluded to the strong federal policy favoring arbitration below, it failed to comply with that policy.

This is especially true here, where the arbitration has been completed and the parties are forced to return to litigate their claims in a different forum. There is no reason PaineWebber should have to re-litigate claims that have been decided in its favor. As this Court has noted, litigants do not give up substantive rights in

arbitration, they merely change the forum for the resolution of their dispute. *Mitsubishi Motors Corp.*, 473 U.S. at 628. Because she has had a full and fair opportunity to litigate her claims, Frye should be required to live with the arbitrators' result. PaineWebber is entitled to the benefit of the arbitrators' decision.

Petitioners respectfully submit that this Court should grant certiorari and reverse the Fifth Circuit's decision in this case, thereby resolving conflict among the Circuits with respect to litigants' waiver of the right to arbitrate.

CONCLUSION

For these reasons, Petitioners respectfully request that this Court issue a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, and reverse the judgment of that Court.

DATED: November 11, 1989.
Dallas, Texas

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Attorneys For Petitioners

CERTIFICATE OF SERVICE

A true and correct copy of this Petition has been sent to Respondent's counsel of record, Joe Bates, Vetto, Bates, Tibbles, Lee & Debusk, 2700 One Main Place, Dallas, Texas 75202.

APPENDIX A

UNITED STATES ARBITRATION ACT

9 U.S.C. § 2.

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3.

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 4.

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure.

The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

APPENDIX B

Nancy C. Frye,

Plaintiff-Appellant,

v.

PAINE, WEBBER, JACKSON & CURTIS, INC., etc., et al.,

Defendants-Appellees.

No. 88-1871

United States Court of Appeals,
Fifth Circuit.

July 18, 1989.

Appeal from the United States District Court for the Northern District of Texas.

Before JOLLY, HIGGINBOTHAM, and SMITH, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

Nancy Frye brought suit against Paine Webber Jackson & Curtis Inc., Dean McGowan, Ken George, and Gary Bassett, asserting federal securities and pendent state law claims. After nearly two-and-a-half years, including extensive discovery and an aborted trial, defendants moved to compel arbitration of Frye's claims. Frye opposed this motion, arguing *inter alia* that defendants had waived their right to seek arbitration by participating in judicial proceedings. The district court granted defendants' motion, holding that any attempt to compel arbitration of Frye's claims before the Supreme Court's rejection of the "intertwining" doctrine in *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985) would have been "futile." The court denied Frye's motion for reconsideration and later confirmed the arbitrators' decision to dismiss her claims. We reject the district court's conclusion that the doctrine of intertwining rendered earlier attempts to compel arbitration "futile," and hold that defendants waived their right to arbitration

by failing to move to compel arbitration during approximately two-and-a-half years of judicial proceedings. We therefore reverse the district court's decision and remand for trial.

I

Frye opened a securities account with Paine Webber in June 1982, signing an agreement which provided that any controversy between the parties would be settled by arbitration. In June 1983, Frye sued Paine Webber and two of its employees, Ken George and Dean McGowan, claiming that she lost over one million dollars in profits due to mismanagement of her account. She asserted violations of section 10(b) of the Securities and Exchange Act of 1934 and various pendent state law claims. She also brought claims under various provisions of the Securities Act of 1933, which she later voluntarily dismissed.

Despite their agreement to arbitrate, defendants never asserted any right to arbitration. Following over a year-and-a-half of discovery and other pretrial activity, trial commenced before Judge Taylor. At the close of Frye's case-in-chief, Judge Taylor granted the Paine Webber defendants' motion for directed verdict, and the case proceeded against a remaining defendant. Judge Taylor, however, later declared a mistrial and set aside the directed verdict. The case was then transferred to Judge Fish.

In April 1985, defendants demanded arbitration based on the Supreme Court's recent decision in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985) (rejecting doctrine of intertwining and holding that arbitrable pendent claims must be arbitrated). In November 1985, they moved to compel arbitration. Frye opposed the motion, arguing that defendants had waived any right to arbitration by participating fully in discovery and trial without demanding arbitration. The trial court granted defendants' motion, staying all proceedings pending arbitration.[1] The district court ruled that any attempt to

[1]The court stayed Frye's claims against Bassett, which are still pending and are not part of this appeal. The court also stayed Frye's claims against the Paine Webber defendants under Section 12(2) of the Securities Act of 1933. Frye later dismissed those claims voluntarily.

compel arbitration of Frye's claims prior to *Byrd* would have been "futile" and that defendants had promptly moved for arbitration after that decision. The court later denied Frye's motion for reconsideration. A panel of arbitrators denied Frye relief. The trial court confirmed the arbitrators' decision and dismissed Frye's claims.

II

On appeal, Frye contends that the trial court erred by compelling arbitration of her claims. She argues that the Paine Webber defendants waived their right to arbitration by their participation in judicial proceedings.

[1,2] A trial court's finding that a party has waived its right to arbitration is subject to *de novo* review, but the factual findings underlying that conclusion may not be overturned unless clearly erroneous. *Price v. Drexel Burnham Lambert, Inc.*, 791 F.2d 1156 (5th Cir. 1986). Despite the strong federal policy favoring arbitration, the right to arbitration may be waived. *Price*, 791 F.2d at 1158 (*citing Miller Brewing Co. v. Fort Worth Distributing Co., Inc. (FWDC)*, 781 F.2d 494, 497 (5th Cir.1986) and *Sedco, Inc. v. Petroleos Mexicanos Mexican National Oil Co. (Pemex)*, 767 F.2d 1140, 1150 (5th Cir.1985). While the party claiming waiver has a heavy burden, " 'waiver will be found when the party seeking arbitration substantially invokes the judicial process to the detriment or prejudice of the other party.' " *Price*, 791 F.2d at 1158 (*quoting Miller Brewing Co.*, 781 F.2d at 497). "Prejudice to the party opposing arbitration, not prejudice to the party seeking arbitration, is determinative of whether a court should deny arbitration on the basis of waiver." *Price*, 791 F.2d at 1162.

In the instant case, the trial court made no findings as to whether Frye was prejudiced, but held that no waiver had occurred because "prior to the *Byrd* decision, a motion to compel arbitration would have been 'futile.' " We later rejected this argument in *Price*, 791 F.2d at 1162-63.

We do not accept Drexel's contention that such a motion would have been futile, and therefore, that a finding of waiver is unjustified in this case. * * * Drexel's argument is undercut by the *Byrd* decision itself, since the decision would never have reached the

Supreme Court but for the defendfant's insistence on arbitration in the face of the intertwining doctrine. Moreover, Drexel's futility argument assumes that the Prices would have objected to arbitration had it been raised *ab initio*.

Id, at 1163. *But see Fisher v. A.G. Becker Paribas Inc.*, 791 F.2d 691, 694-97 (9th Cir. 1986) (failure to move to compel arbitration during three-and-a-half years of pertrial activity did not constitute waiver since arbitration agreement was unenforceable prior to *Byrd*). The district court erred by finding that the intertwining doctrine rejected in *Byrd* justified defendants' delay in seeking arbitration of Frye's claims.

[3] "While the mere failure to assert the right of arbitration does not alone translate into a waiver of that right . . . such failure does bear on the question of prejudice, and may, along with other considerations, require a court to conclude that waiver has occurred." *Price*, 791 F.2d at 1161. Both delay and the extent of the moving party's participation in judicial proceedings are material factors in assessing a plea of prejudice. *Id.*

In *Price*, we held that plaintiffs had been sufficiently prejudiced by defendant's seventeen-month delay in seeking arbitration, including the time and expense in responding to discovery and a motion for summary judgment, to conclude that defendants had waived their contractual right to arbitration. *Price*, 791 F.2d at 1160-62.[2] *See also Fraser v. Merrill Lynch Pierce, Fenner & Smith, Inc.*, 817 F.2d 250 (4th Cir. 1987) (sufficient prejudice to support waiver where brokerage firm delayed four-and-one-half years before seeking arbitration, two trial dates had passed, and opposing party was required to respond to motion for partial summary judgment and three motions to dismiss). *But see Rush v. Oppenheimer & Co.*, 779 F.2d 885 (2d Cir. 1985) (insufficient prejudice to

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[2]The trial court found that Drexel had "initiated extensive discovery, answered twice, filed motions to dismiss and for summary judgment, filed and obtained two extensions of pre-trial deadlines, all without demanding arbitration." The court concluded that the "mounting attorneys fees," "seventeen month delay," and "disclosure which has resulted from the numerous depositions and production of documents" constituted sufficient prejudice to find that Drexel had waived its right to compel arbitration. 791 F.2d at 1159.

support waiver where securities firm delayed eight months in seeking arbitration, filed answer, moved to dismiss claims, and conducted discovery); *Fisher*, 791 F.2d at 698 (insufficient prejudice to support waiver where brokerage firm delayed three-and-a-half years before seeking arbitration, filed pretrial motions, and engaged in extensive discovery); *Page v. Moseley, Hallgarten, Estabrook & Weeden*, 806 F.2d 291 (1st Cir. 1986) (insufficient prejudice to support waiver where brokerage firm delayed one year before moving to compel arbitration and only prejudice incurred was time and expense of discovery).

[4] Defendants contend that *Price* is distinguishable because Price had been subjected to the burden of defending against a motion for summary judgment before Drexel moved to compel arbitration. Defendants' attempt to distinguish *Price* is unpersuasive, particularly in ignoring the fact that Frye has incurred the time and expense of an aborted trial.

Frye argues that she was prejudiced by (1) defendants' use of judicial discovery procedures not available in arbitration; (2) substantial attorneys' fees and costs incurred during pretrial proceedings and an aborted trial; (3) the time and expense of defending against defendants' claims for affirmative relief, including a cross-claim and a motion for directed verdict; and (4) the passage of approximately two-and-a-half years time. In light of these undisputed facts, we hold that Frye was sufficiently prejudiced by defendants' participation in discovery and trial to conclude that defendants waived their contractual right to arbitration. We therefore reverse the trial court's decision compelling arbitration of Frye's claims and remand for trial.

REVERSED AND REMANDED.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

NANCY C. FRYE,

Plaintiff,

v.

PAINE WEBBER JACKSON & CURTIS, et al.,

Defendants.

Civil Action No.
CA 3-83-1061-G

MEMORANDUM ORDER

This case is before the court on the motion of defendants Paine Webber Jackson & Curtis, et al. ("Paine Webber") to compel arbitration and to stay the litigation pending arbitration. For the reasons stated below, the court is of the opinion that the motion should be granted.

I. Background

Plaintiff Nancy C. Frye ("Frye") opened an account with Paine Webber on June 11, 1982, transferring into that account 12,212 shares of Commodore International, Ltd. Paine Webber employees Ken George ("George") and Dean McGowan ("McGowan"), defendants herein, allegedly recommended to Frye that she open an option account with Paine Webber, proposing an elaborate scheme to use the Commodore stock to generate income. George and McGowan reportedly assured Frye that the recommended course of action would not jeopardize her ownership of the Commodore stock. Gary Bassett ("Bassett"), Frye's consultant, allegedly agreed with the proposed scheme. Due to alleged mismanagement, Frye lost most of her Commodore stock and, since the market value of the stock appreciated,

allegedly was denied the opportunity to obtain profits in excess of $1,000,000.00.

Frye asserts claims under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), Rule 10b-5, 17 C.F.R. §240.10b-5, and various provisions of the Securities Act of 1933, 15 U.S.C. §§77a *et. seq.* She also asserts pendent state-law claims, including statutory and common law fraud, breach of contract, breach of fiduciary duties, and negligence.

The case was tried earlier this year before the Honorable William M. Taylor, Jr. On February 21, 1985, Judge Taylor granted Paine Webber's motion for directed verdict. The case then proceeded against a remaining defendant until, upon Frye's motion, Judge Taylor granted a mistrial. The case was subsequently transferred to the undersigned for futher proceedings.

II. The Arbitration Agreement

Paragraph 15 of the agreement between Paine Webber and Frye provides for arbitration of certain controversies:

> Any controversy between us arising out of or relating to this contract or the breach thereof, shall be settled by arbitration, in accordance with the rules, then obtaining, of either the Arbitration Committee of the New York Stock Exchange, American Stock Exchange, National Association of Securities Dealers or where appropriate, Chicago Board Option Exchange or Commodities Futures Trading Commission as I [Frye] may elect. I authorize you if I do not make such election, by registered mail addressed to you at your main office within fifteen (15) days after receipt of notification from you requesting such election, to make such election in my behalf. Any arbitration hereunder shall be before at least three arbitrators and the award of the arbitrators, or a majority of them, shall be final, and judgment upon the award rendered may be entered in any court, state or federal, having jurisdiction.

On April 3, 1985, counsel for Paine Webber sent a letter to Frye's counsel requesting arbitration. Neither Frye nor her counsel responded. On April 24, 1985, counsel for Paine Webber sent a letter to Frye's counsel selecting arbitration before the Arbitration Committee of the New York Stock Exchange.

Frye asserts that the arbitration paragraph does not mandate arbitration but merely provides an opportunity timely to elect arbitration. Neither party contests the applicability of the arbitration agreement to the securities claims if the court determines that they are arbitrable. Frye contends, however, that by willingly and actively participating in and seeking affirmative relief in judicial proceedings for over two years, Paine Webber has waived the right to seek arbitration of any disputes. Frye further asserts that even if the pendent state claims are found arbitrable, the claims arising under the securities acts are not arbitrable as a matter of federal law.

III. Analysis

A. The Arbitration Act

9 U.S.C. §2 provides for the validity and enforceability of arbitration agreements:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

The Arbitration Act evinces a strong national policy favoring arbitration whenever the parties opt for that method of dispute resolution. Houston General Insurance Company v. Realex Group, N.V., 776 F.2d 514, 516 (5th Cir. 1985). In light of the federal policy favoring arbitration, any

written agreement to submit a dispute to arbitration should be liberally construed, and any doubt as to arbitrability of an issue should be resolved in favor of arbitration. Austin Municipal Securities, Inc. v. National Association of Securities Dealers, Inc., 757 F.2d 676, 696 (5th Cir. 1985). *See* Mitsubishi Motors Corporation v. Soler Chrysler-Plymouth, Inc., _____ U.S. _____, 105 S. Ct. 3346, 3353-54 (1985); Southland Corporation v. Keating, 465 U.S. 1, _____, 104 S. Ct. 852, 860 (1984); Moses H. Cone Memorial Hospital v. Mercury Construction Corporation, 460 U.S. 1, 24, 103 S. Ct. 927, 941-42 (1983).

B. The Effect of Dean Witter Reynolds, Inc. v. Byrd

In Dean Witter Reynolds, Inc. v. Byrd, _____ U.S. _____, 105 S. Ct. 1238 (1985), the Supreme Court held that a court may not deny a motion to compel arbitration of state-law claims pursuant to an arbitration agreement when a complaint raises both federal securities and pendent state claims. The court further held that the section 2 directive is mandatory:

> By its terms, the [Federal Arbitration] Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed.

Id. at 1241 (emphasis in original). *See* NPS Communications, Inc. v. Continental Group, Inc., 760 F.2d 463, 465 (2d Cir. 1985); *Austin Municipal Securities*, 757 F.2d at 697.

C. Waiver

Frye argues that Paine Webber has nevertheless waived any right it may have had to compel arbitration. The court does not agree. First, the burden of one seeking to prove waiver of arbitration is a heavy one. Tenneco Resins, Inc. v. Davy International, AG, 770 F.2d 416, 420 (5th Cir. 1985); Sibley v. Tandy Corporation, 543 F.2d 540, 542 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

Second, the Supreme Court stated in *Moses Cone* that

> the Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of *waiver, delay,* or a like defense to arbitrability.

Moses Cone, 460 U.S. at 24-25 (emphasis added).

Third, prior to the *Dean Witter* decision, a motion to compel arbitration would have been futile. Previously, the Fifth Circuit adhered to the doctrine of intertwining, *see* 105 S. Ct. at 1240, which dictated that if arbitrable and nonarbitrable claims were factually and legally inextricably intertwined, the federal court could retain jurisdiction over the entire case. *See, e.g.,* Commerce Park at DFW Freeport v. Mardian Construction Company, 729 F.2d 334, 339 (5th Cir. 1984); Smoky Greenhaw Cotton Co., Inc. v. Merrill Lynch, Pierce Fenner & Smith, Inc., 720 F.2d 1446, 1448 (5th Cir. 1983); Miley v. Oppenheimer & Company, Inc., 637 F.2d 318, 334-37 (5th Cir. 1981). The court in *Dean Witter* expressly rejected the doctrine, *see* 105 S. Ct. at 1240-41, and held that the necessity of bifurcating proceedings did not eliminate arbitration as an alternative method of dispute resolution:

> The legislative history of the Act establishes that the purpose behind its passage was to ensure judicial enforcement of privately made agreements to arbitrate. We therefore reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims. The Act, after all, does not mandate the arbitration of all claims, but merely the enforcement — upon the motion of one of the parties — of privately negotiated arbitration agreements.

Id. at 1242.

The *Dean Witter* opinion was issued March 4, 1985. Paine Webber requested arbitration on April 3, 1985. Since the decision, Paine Webber has not participated in discovery,

amended its pleadings, or otherwise acted to suggest waiver of arbitration. Consequently, Frye had not carried its "heavy burden" of establishing that Paine Webber waived its right to arbitration.

D. Securities Act of 1933

Frye argues that, even if *Dean Witter* requires arbitration of the pendent claims, her securities claims, founded on laws evincing a unique legislative intent to regulate securities transactions uniformly, must be resolved in a judicial forum.

In Wilko v. Swan, 346 U.S. 427 (1953), the Supreme Court held invalid agreements to arbitrate claims arising under the 1933 Securities Act. The court based its decision on three interrelated provisions of the 1933 Act. Section 12(2), 15 U.S.C. §77*l*(2), provides a "special right to recover for misrepresentation which differs substantially from the common law action," which requires a judicial forum to assure its effectiveness. Section 22, 15 U.S.C. §77v(a), provides for state and federal jurisdiction, nationwide service of process, and a wide choice in venue in federal court. Finally, section 14, 15 U.S.C. §77n, voids any "condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision" of the 1933 Act. 346 U.S. at 430-31.

The *Wilko* Court ruled that an agreement to arbitrate "is a 'stipulation,' and . . . [that] the right to select the judicial forum is the kind of 'provision' that cannot be waived under §14 of the Securities Act [of 1933]." 346 U.S. at 434-35. Thus, the *Wilko* court resolved the conflict between the policy favoring arbitration and the policy underlying the 1933 Securities Act in favor of the 1933 Act:

> Two policies, not easily reconcilable, are involved in this case. Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment. On the other hand, it has enacted the

> Securities Act to protect the rights of investors and has forbidden a waiver of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the [1933] Act.

Id. at 438.

In Scherk v. Alberto-Culver Company, 417 U.S. 506 (1974), the Supreme Court reaffirmed the validity of *Wilko* as to claims under the Securities Act of 1933 but declined to extend its reach to claims arising under the Securities Exchange Act of 1934. 417 U.S. at 511-15. The Fifth Circuit, on the other hand, has espoused the view that *Wilko* applies to claims under both statutes. *See, e.g.,* Sawyer v. Raymond James & Associates, Inc., 642 F.2d 791, 792 (5th Cir. 1981); *Sibley,* 543 F.2d at 543. Whichever reading of *Wilko* is correct, it is safe to say that at least any of Frye's claims arising under the 1933 Act are not arbitrable.[1]

E. Securities Exchange Act of 1934

Although the plaintiffs in *Dean Witter* urged §10(b) and Rule 10b-5 claims, the Supreme Court expressly declined to

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[1]The court is unable to discern, however, exactly what claims Frye may be alleging under the 1933 Act. Although the joint pretrial order submitted February 8, 1985 asserts that jurisdiction and venue exist under the 1933 Act (page 1), Frye's claims (pp. 2-11) explicitly mention the 1933 Act only once, in the context of "controlling person" liability for Paine Webber (p. 10). Similarly, her memorandum in opposition to arbitration filed November 26, 1985 refers to claims under the 1933 Act (pp. 1-2) but discusses only claims under Rule 10b-5 of the 1934 Act (pp. 16-21). It thus appears that most, if not all, of Frye's federal securities claims arise under the Securities Exchange Act of 1934. The arbitrability of those claims is discussed below.

consider the arbitrability of these claims.[2] Nevertheless, some guidance as to the court's view of the arbitrability of statutory claims was provided in its later *Mitsubishi* decision. The court there held that an agreement to arbitrate antitrust claims should be enforced if the agreement arises from an international transaction. 105 S. Ct. at 3361.

Although the instant case does not involve an international transaction, the *Mitsubishi* court seemed receptive to arbitration of statutory claims, noting that "we find no warrant in the Arbitration Act for implying in every contract within its ken a presumption against arbitration of statutory claims." 105 S. Ct. at 3353. Section 2 and the Arbitration Act as a whole manifest "a policy guaranteeing the enforcement of private contractual agreements." *Id.*

After cautioning that not all controversies implicating statutory rights were proper subjects for arbitration, the court noted that the critical determination was whether Congress' intention as to the substantive protection afforded by a given statute, deducible from the text or the legislative history, was to include protection against waiver of the right to a judicial forum. *Id.*

Justice White, concurring in *Dean Witter,* suggested that section 10(b) and Rule 10b-5 are arbitrable. He reasoned that jurisdiction under the 1934 Act, restricted to the federal courts, is narrower than under the 1933 Act. *See* 15 U.S.C. §78aa; 15 U.S.C. §77v. Furthermore, the cause of action under §10(b) and Rule 10b-5 is implied rather than express and more like the commonlaw action. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 380 and nn.9-10 (1983). Thus, solicitude for the federal judicial cause of action is less appropriate. 105 S. Ct. 1244.

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[2]"Dean Witter and *amici* representing the securities industry urge us to resolve the applicability of *Wilko* to claims under §10(b) and Rule 10b-5. We decline to do so. In the District Court, Dean Witter did not seek to compel arbitration of the federal securities claims. Thus, the question whether *Wilko* applies to §10(b) and Rule 10b-5 claims is not properly before us."

After a review of recent decisions on this subject, this court concludes that Congress has not evinced an intent to preclude arbitration of claims arising under the 1934 Act. *See, e.g.*, Osborne v. Shearson Lehman/American Express, Inc., No. CA 3-85-1340-F (N.D. Tex. October 1, 1985); McMahon v. Shearson/American Express, Inc., CCH Fed. Sec. L. Rep. §92,319 (1985 Transfer Binder) (S.D.N.Y. 1985); Finkle & Ross v. A.G. Becker Paribas, Inc., Nos. 85 Civ. 1858, 85 Civ. 2284 (S.D.N.Y. December 2, 1985); McKinney v. Sutton, C.A. No. C-85-15 (S.D. Tex. November 8, 1985); Byrd v. Dean, Witter, Reynolds, Inc., No. 82-1655-T (S.D. Calif. July 8, 1985); Finn v. Davis, No. 84-8414-Civ.-Gonzalez (S.D. Fla. June 19, 1985); Coonly v. Rotan Mosle, No. A-83-CA-529 (W.D. Tex. June 11, 1985).

Accordingly, the court concludes that Frye's section 10(b) and Rule 10b-5 claims are arbitrable.

IV. Stay Pending Arbitration

Section 3 of the Arbitration Act provides for a stay of proceedings when an issue therein is referable to arbitration:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. §3 (West 1970).

Frye asserts that the litigation should not be stayed because defendants McGowan and George were not parties to the arbitration agreement. Under the Arbitration Act, however, an arbitration agreement must be enforced notwithstanding the presence of other persons who are

parties to the underlying dispute but not to the arbitration agreement. *Tenneco Resins, Inc.*, 770 F.2d at 422.

To control its docket, conserve judicial resources, and provide for a just determination of the case pending before it, *Moses H. Cone*, 103 S. Ct. at 939 n.23; Contracting Northwest v. City of Fredericksburg, 713 F.2d 382, 387 (8th Cir. 1983), a district court has inherent power to grant a stay of all proceedings pending arbitration. The Fifth Circuit rule is that "if some claims are arbitrable and others are not and they are easily severable . . ., the court should stay proceedings as to those claims which are arbitrable." Coastal (Bermuda) Ltd. v. E.W. Saybolt & Co., Inc., 761 F.2d 198, 203 n.6 (5th Cir. 1985); Wick v. Atlantic Marine, Inc., 605 F.2d 166, 168 (5th Cir. 1979); Sibley v. Tandy Corporation, 543 F.2d at 544.

The court concludes that the claims are not easily severable and that concurrent disposition would be inexpedient and judicially wasteful; consequently, the court orders a stay of all proceedings pending arbitration of the arbitrable issues.

V. Conclusion

For the reasons stated above, Paine Webber's motion to compel arbitration is GRANTED. All proceedings herein shall be stayed pending resolution of the arbitrable issues. The parties are directed to report to the court in writing the status of the arbitration within ten (10) days after the decision is made by the arbitrators or, in any event, by June 30, 1986.

SO ORDERED.

December 26, 1985.

A. JOE FISH

A. Joe Fish
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

NANCY C. FRYE,

Plaintiff,

v.

PAINE WEBBER JACKSON & CURTIS, et al.,

Defendants.

Civil Action No.
CA 3-83-1061-G

ORDER

On December 26, 1985, this court entered its order compelling arbitration in this case. On April 27, 1987, a panel of arbitrators from the National Association of Security Dealers dismissed plaintiff's claims in their entirety. On May 22, 1987, defendants filed a motion to confirm the arbitration award. On July 29, 1987, plaintiff filed a supplemental response in which she informed the court that she will not challenge the arbitration decision. Moreover, plaintiff stated that she will not pursue any claims not disposed of by the arbitration decision.

Accordingly, it is ORDERED that defendants' motion to confirm the arbitration award be GRANTED. It is further ORDERED that all other claims of plaintiff in this action be DISMISSED with prejudice.

It is further ORDERED that each party shall bear its own costs and expenses, including attorney's fees.

October 14, 1987.

A. JOE FISH
A. Joe Fish
United States District Judge

APPENDIX E

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 88-1871

NANCY C. FRYE,
Plaintiff-Appellant,
versus

PAINE, WEBBER, JACKSON & CURTIS, INC., ETC., ET AL.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

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ON PETITION FOR REHEARING

(August 15, 1989)

Before JOLLY, HIGGINBOTHAM and SMITH, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

PAT S. HIGGINBOTHAM
United States Circuit Judge

No. 89-809

In The
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1989

Paine Webber, Inc.,
Kennard L. George and
Dean McGowan,

Petitioners,

vs.

Nancy C. Frye,

Respondent.

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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RESPONSE TO QUESTION PRESENTED

The Fifth Circuit's decision in Frye v. Paine Webber, et al., 877 F.2d 396 (1989) did not hold that a contractual right to arbitration was waived "merely" by virtue of the failure to file a motion to compel arbitration prior to this Court's decision in Dean Witter Reynolds Inc. v. Byrd, 270 U.S. 213 (1985). Rather, the Fifth Circuit held that the "futility," vel non, of moving to compel arbitration prior to Byrd, standing alone, was not controlling on the issue of whether Petitioners had waived their contractual rights to elect or insist upon arbitration, an issue to be determined on the basis of the totality of the circumstances, Petitioners' affirmative acts and/or inactions, and the prejudice occasioned by Respondent. The Fifth Circuit's decision on the waiver issue in this case simply is not in conflict with the decision of this Court or other Circuit Courts of Appeal.

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No. 89-809

In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1989

Paine Webber, Inc.,
Kennard L. George and
Dean McGowan,

Petitioners,

vs.

Nancy C. Frye,

Respondent.

RESPONSE TO PETITION FOR A WRIT
OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Respondent, Nancy C. Frye, Plaintiff below, respectfully files this, its response to petition by Defendants Paine Webber, Inc., Kennard L. George, and Dean McGowan for writ of certiorari to review the opinion of the United States Court of Appeals for the Fifth Circuit, entered on July 18, 1989, which reversed an Order of the United States District Court for the Northern District of Texas, entered on October 14, 1985, and prays that Petitioner's request for said writ be denied or, in the alternative, that this Court, in its wisdom, uphold the correct decision of the Fifth Circuit Court of Appeals.

OPINION BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 877 F.2d 396, and is reproduced at Appendix A.

STATEMENT OF THE CASE

In summer, 1982 Nancy C. Frye ("Frye"), Plaintiff-Respondent, opened a securities account with Paine Webber, Jackson, & Curtis, Inc. ("Paine Webber"), entrusting Paine Webber's agents with the protection of her investments. Frye's account, throughout her relationship with Paine Webber, was handled by Paine Webber's employee Ken George and by Paine Webber's Dallas Branch Manager Dean McGowan. Paine Webber and its authorized agents informed Frye that her investments would be managed by means of selling options, a strategy that was to involve the least possible risk to the investor. Trusting their abilities and judgment, Frye signed a Customer's Agreement requiring in part that any dispute arising between Paine Webber and Frye be settled through arbitration.

A dispute arose when, in 1982, Paine Webber lost securities it had invested for Frye. Although Frye and Paine Webber discussed this matter for several months without coming to any satisfactory resolution, Paine Webber failed to notify Frye that it wished to exercise its contractual right to submit the dispute for arbitration. Frye thereupon filed suit on June 16, 1983 in the United States District Court for the Northern District of Texas, Dallas Division, against Paine Webber, McGowan, and George (hereafter collectively referred to as "Paine Webber") as well as Gary Bassett, a private financial advisor, for their breaches of state law and for federal securities violations. Jurisdiction in the Federal District Court was deemed proper.

The case went to trial in February, 1985, more than 19 months after it had originally been filed. In the intervening period of time, Paine Webber participated in extensive litigation, making full use of discovery, asserting counterclaims, and taking part in a trial. As a result of the necessity to respond to Defendant's discovery efforts and to engage in intensive trial preparation, Frye incurred substantial legal and attorney's fees.

The trial proceeded for approximately two weeks in the court of Judge Taylor, until the latter, who suffered from serious illness which eventually led to his unfortunate death, granted a mistrial. The case was then assigned to the Honorable A. Joe Fish for disposition.

Neither during the discussions before Frye filed suit, nor during pretrial discovery or in the course of the trial itself, did Paine Webber engage in any attempt to act upon its contractual right to have the dispute arbitrated by advising Frye of its desire to proceed to arbitration. Paine Webber furthermore did not plead arbitration as an affirmative defense in its answer, nor did it file a Motion to Compel arbitration prior to the mistrial. Paine Webber finally filed a motion to compel Arbitration in October, 1985 — more than 8 months after the aborted trial and 7 months after March 4, 1985, when this Court decided the case of Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985).

While this Motion was opposed by Frye, it was erroneously granted by the District Court, which overruled Frye's arguments that Paine Webber had waived its right to arbitration. The district court did not rule as to whether Frye had been severely prejudiced due to: i) the passage of an extended period of time prior to the filing of the Petitioners' motion, ii) the extensive use of judicial discovery procedures, which are not available in arbitration, iii) the time and expense incurred during pretrial proceedings and an aborted trial, and iv) defending against Paine Webber's claims for affirmative relief, including a cross-claim and motion for directed verdict.

Subsequent to arbitration, Frye immediately appealed to the Fifth Circuit Court of Appeals. In reversing the trial court's decision to compel arbitration, the Fifth Circuit Court of Appeals held that Frye had suffered substantial prejudice and that the District Court had erred in not so finding.

REASON FOR NOT GRANTING WRIT

INTRODUCTION

The Petitioners pose their question to this Court as follows:

> Should a party to an arbitration agreement be denied its contractual rights merely because it did not file a motion to compel arbitration before this Court decided Dean Witter Reynolds Inc. v. Byrd, 270 U.S. 213 (1985), at a time when such a motion would have been futile?

Premised upon the above-quoted inaccurate characterization of the Fifth Circuit's decision, Petitioners assert that such a holding stands in direct conflict with the decisions of the Eleventh Circuit in Benoay v. Prudential-Bache Securities, Inc., 805 F.2d 1437 (11th Cir. 1986); the First Circuit in Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 294 (1st Cir. 1986); the Ninth Circuit in Conover v. Dean Witter Reynolds, Inc., 837 F.2d 867 (9th Cir. 1987); and the Second Circuit in Rush v. Oppenheimer & Co., 779 F.2d 885 (2nd Cir. 1985).

The Petitioners assert that these other Circuits have held that "any delay or participation in discovery or trial prior to Byrd cannot constitute a basis for a finding of waiver due to the 'futility' of any motion to compel arbitration filed prior to Byrd." Restated, Petitioners take the position that these other Circuits and this Court have heretofore held, contrary to the Fifth Circuit's decision, that Petitioners' right to arbitration did not "arise" or "accrue" until March 4, 1985 — the day Byrd was decided. In the words of Petitioners:

> The Fifth Circuit puts litigants in an intolerable position, because Petitioners are held to have forfeited a right **they did not have** until March 4, 1985. (Emphasis added)

Respondent submits that Petitioners' myopic view of the holding of the Fifth Circuit is inaccurate, and that Petitioners' interpretation of the holdings of the other cited Circuits is equally fallacious. While it is certainly true that other Circuits have taken the view that the filing of a motion to compel prior to the decision in Byrd might have been futile in view of the intertwining doctrine, it simply is not true that any of the other Circuit Courts of Appeal or this Court

has held: (1) that there was no right to elect or invoke a contractual right to arbitration prior to Byrd; (2) that no right to arbitration could have been waived prior to the Byrd decision by the party holding the right through their actions or inactions depending on the stage of the proceeding at which the right is first asserted, any prejudice to the other party occasioned by the delay in assertion of the right, and/or other circumstances relevant to the issue of waiver; or (3) that the traditional and uniformly applied test for waiver of contractual arbitration rights was rendered inapplicable to any securities case decided prior to the announcement of the decision in Byrd. In fact, viewed in proper perspective, Petitioners themselves are seeking to establish a new rule at odds with the holdings of the other Circuits in the cases cited as they attempt to suggest that the case authority in other Circuits have considered the "futility" argument alone in determining whether waiver should or should not be granted. It is Petitioners' misinterpretation of the decisions relied upon which is in conflict with existing authority.

I.

THE FIFTH CIRCUIT DID NOT BASE ITS FINDING OF WAIVER SOLELY ON THE FAILURE OF PAINE WEBBER TO MOVE TO COMPEL ARBITRATION PRIOR TO BYRD

In this instance, the Fifth Circuit determined that despite the strong federal policy favoring arbitration, the right to arbitrate could nevertheless be waived. (Frye, id at P. 399) Miller Brewing Co. v. Fort Worth Distributing Co., Inc., 781 F.2d 494, 497 (5th Cir. 1986); Sedco, Inc. v. Petroleos Mexicanos Mexican Nation Oil Co., 767 F.2d 1140, 1150 (5th Cir. 1985)). Quoting from the decision in Price v. Drexel Burnham Lambert, Inc., 791 F.2d 1156, 1163 (5th Cir. 1986) the Fifth Circuit stated:

> . .the Arbitration Act had never been intended to abrogate a party's right to arbitration but rather, as this Court noted in Byrd, in enacting the Arbitration Act the purpose of the House of Representatives had been specifically to "place an arbitration agreement 'upon the same footing as other contracts, where it belongs.'" (Byrd, id, at P. 219)

Further, the Federal Arbitration Act, by specifically addressing waiver as one of the defenses as to whether a claim is arbitratable, has recognized that waiver constitutes an inherent recourse in contractual arbitration agreements.

The Petitioners' question, as stated, suggests that the Fifth Circuit's ruling must be interpreted to mean that a party may be found to have waived its right to arbitration solely as a result of having failed, prior to Byrd, to file a motion to compel arbitration. In fact, the Fifth Circuit's decision holds that a failure to assert one's right to arbitration is only one of several factors in addressing the issue of waiver. In examining the lower court's erroneous decision to grant Paine Webber's Motion to Compel arbitration, the Fifth Circuit remarked in Frye, id. at P. 388:

> In the instant case, the trial court made no finding as to whether Frye was prejudiced, but held that no waiver had occurred because 'prior to the Byrd decision, a motion to compel arbitration would have been "futile".'

The Fifth Circuit went on to quote Price v. Drexel Burnham Lambert, Inc., 791 F.2d 1156, 1161 (5th Cir. 1986), stating that "we do not accept [the] contention that such a motion would have been futile, and therefore, that a finding of waiver is unjustified in this case" (Frye, id at P. 388); and, in addressing Paine Webber's failure to request arbitration as was its contractual right under the existing agreement, noted:

> While the mere failure to assert the right of arbitration does not alone translate into a waiver of that right. . . such failure does bear on the question of prejudice, and may, **along with other considerations**, require a court to conclude that waiver has occurred. [emphasis added]

In overruling the decision of the lower court in this instance and determining that a waiver had occurred, the Fifth Circuit took into consideration not only Paine Webber's failure to file a motion to compel arbitration, but a number of other factors, not the least of which were Paine Webber's complete neglect in asserting a contractual right to arbitration by informing Frye of its election to arbitrate, Paine Webber's failure at any time to plead a right to arbitration, as a defense or otherwise, filing of the affirmative claims for relief by Paine Webber, and the totality of other circumstances demonstrating

substantive prejudice to Frye. The Fifth Circuit did not base its decision solely on the failure to file a motion to compel arbitration. Rather, it merely rejected the "futility", vel non, of successfully compelling arbitration prior to Byrd as the sole determinant of the waiver issue.

II.

THE FIFTH CIRCUIT APPLIED GENERALLY ACCEPTED STANDARDS DETERMINING WHETHER PREJUDICE SUFFICIENT TO CONSTITUTE WAIVER HAD OCCURRED

In determining whether a court should deny arbitration on the basis of waiver, the party opposing arbitration must show that it will incur substantial prejudice as a consequence. Miller Brewing, Id. at 497; E.C. Ernst, Inc. v. Manhattan Construction Co. of Texas, 559 F.2d 268, 269 (5th Cir. 1977). The courts have generally interpreted the section of the Arbitration Act relevant to waiver to create a heavy burden on the party seeking to claim prejudice. Sibley v. Tandy Corp., 543 F. 2d 540, 542 (5th Cir. 1976) cert. denied, 434 U.S. 824.

More specifically, of the factors which, when found in some combination, may be considered sufficient prejudice to constitute waiver of otherwise arbitratable claims, the courts have over the course of time examined particularly the following: participation in pretrial discovery; failure to plead arbitration as an affirmative defense; forcing the opposing party to respond to motions; forcing the opposing party to respond to a motion for summary judgment; and failure to request arbitration prior to litigation.

In the instant case, the Fifth Circuit, in its deliberations whether Frye had suffered prejudice of sufficient magnitude to deem that Paine Webber had waived its contractual right to arbitration, was faced with a substantial series of prejudicial factors, including:

(1) the use of the judicial discovery procedures by Paine Webber not available in arbitration;

(2) the substantial attorney's fees and costs incurred by Frye during both pretrial proceedings and an aborted trial;

(3) the time and expense of defending against Paine Webber's claims for affirmative relief, including a cross-claim and motion for directed verdict;

(4) the passage of approximately two-and-a-half years time;

(5) the complete failure of the Petitioners to ever plead arbitration as an affirmative defense or to ever notify Frye of Paine Webber's election of arbitration;

(6) the delay of Paine Webber in filing a motion to compel arbitration until October, 1985, approximately 8 months after the aborted trial and approximately 7 months after this Court's decision in Byrd.

Based upon these foregoing considerations, the Fifth Circuit was compelled to find that Frye had suffered prejudiced sufficient to constitute waiver.

III.

THE FIFTH CIRCUIT'S DECISIONS IS IN ACCORDANCE WITH THE DECISION OF OTHER CIRCUIT COURTS OF APPEAL

A number of cases involving less prejudical factual situations have been selected by Petitioners for the purpose of supporting their contention that the Fifth Circuit decision should be viewed as conflicting with other circuit authority: Benoay v. Prudential-Bache Securities, Inc., 805 F.2d 1437 (11th Cir. 1986); Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 294 (1st Cir. 1986); Conover v. Dean Witter Reynolds, Inc., 837 F.2d 867 (9th Cir. 1987); Rush v. Oppenheimer & Co., 779 F.2d 885 (2nd Cir. 1985). While these cases have evidenced some of the elements determined to be indicative of prejudice, their cumulative effects fell just short of the respective Court of Appeals' tests for waiver, which consequently was not granted.

Petitioners fail to address the numerous other cases where courts have found waiver to exist under facts similar to, albeit less compelling than, those present in this case: E.C. Ernst Inc. v. Manhattan Construction Company of Texas, 551 F.2d 1026, 1040-41(5th Cir. 1977) failure to request arbitration as waiver; Price vs. Drexel Burnham Lambert, Inc., 791 F.2d 1156(5th Cir. 1986); Bengiovi v. Prudential-Bache Securities, Inc., Fed.Sec. L. Rep. (CCH) 92,012 at 91,013 (April 25, 1985) delay 8 1/2 months after complaint had been filed, failure to raise defense of arbitration, participation in discovery, moving for partial summary judgment; Miller Brewing Co. v. Fort Worth Distributing Co. Inc., 781 F. 2d 494, 497 (5th Cir. 1986) waiver will be found when party seeking arbitration substantially invokes the judicial process to the detriment of the other party by demonstrating a clear and unmistakable "disinclination" to arbitrate, including a 3 1/2 year delay, defending against claims, participating in discovery, expending money for legal fees and personal time to prepare, and use of pretrial discovery for arbitration. Further cases where waiver has been found to have occurred under far less prejudicial factual circumstances than exist in the instant case include: Sedco, Inc. v. Petroleos Mexicanos Mexican National Oil Co., 767 F.2d 1140(5th Cir. 1985); Burton Dixie Corp. v. Timothy McCarthy Construction Co., 436 F.2d 405 (5th Cir. 1971); Cornell & Co. v Barber & Ross Co., 360 F.2d 512 (D.C. Cir. 1966); and Fraser v. Merrill Lynch, Pierce, Fenner, & Smith, Inc., 817 F.2d 250 (4th Cir. 1987).

It is respectfully submitted that courts which have found prejudice sufficient to constitute waiver have done so under far less prejudicial circumstances than have confronted Frye. Indeed, the Petitioners would have this Court believe that the subject of participation in a trial as one of the factors comprising prejudice had been deliberated in other Circuit authority and, thus, there is a conflict between these Circuits and the Fifth Circuit's decision in Frye:

> The Fifth Circuit's determination that the right to arbitration had been waived due to Paine-Webber's pre-Byrd participation in discovery **and trial** is in direct conflict with . . . [these decisions]. (Petitioner's Petition for Writ of Certiorari at Page 4, emphasis added)

This claim, however, has no basis in fact. Although the decisions in the cases named above unquestionably set some standards whereby waiver could be determined, none elaborate upon the issue of participating at trial as an element of waiver, as it applies to the Respondent. Indeed, no court has ever directly addressed the issue of prejudice in relation to an aborted trial during which the party seeking prejudice has presented its entire case. We suggest that there can be few additional elements of prejudice not faced by Frye that could potentially be deemed necessary for a finding of waiver. To extend the scope of factors integral to a determination of prejudice sufficient to constitute waiver, moreover, might seriously limit the possibility that any party to a contract could ever waive its contractual rights.

IV.

PETITIONERS' RIGHT TO ARBITRATION AROSE FROM CONTRACT AND DID NOT SPRING FROM THIS COURT'S DECISION IN BYRD

It is not the case that the Petitioners lacked the right to arbitrate before the decisions of Dean Witter Reynolds, Inc. v. Byrd, supra, and Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987). The Client Agreement containing the arbitration clause in question affords either party to the agreement the ability to elect arbitration at any time simply by providing written notice to the other party, even while at all times retaining its contractual right to seek or to waive enforcement of arbitration. Burton-Dixie Corporation v. Timothy McCarthy Construction Co., 436 F.2d 405, 407-408 (5th Cir. 1971); E.C. Ernst, Inc. v. City of Tallahassee, 527 F.Supp. 1141, 1142-1143 (N.D. Fla. 1981).

Significantly, Paine Webber did not exercise this option or indicate to Frye that it wished to proceed to arbitration at any point prior to filing its motion to compel after Frye had already been put to the effort and expense of trial. It was in part because the Petitioners had failed to act upon this right granted them by the Client Agreement that the Fifth Circuit noted that it had already overruled the issue of futility in Price, id., at P. 1163, wherein the Fifth Circuit noted that "[the] futility argument assumes that the [other party] would have objected to arbitration had it been raised ab initio." Further, if the

Petitioners had truly wished to protect their right to arbitration, their failure to plead arbitration as an affirmative defense, which had been judicially tested, must also be taken into account.

Thus the Petitioners erroneously claim that their right to arbitration did not accrue until March 4, 1985, when this Court rendered its decision in Byrd, id. By referencing the Federal Arbitration Act as a means to excuse their failure to request arbitration, the Petitioners neglect the fact that arbitration had always constituted an option under the Client Agreement. Moreover, the Arbitration Act was never intended to abrogate a party's right to arbitration but rather, as this Court noted in Byrd, in enacting the Arbitration Act the purpose of the House of Representatives had been specifically to "place an arbitration agreement 'upon the same footing as other contracts, where it belongs.'" (Byrd, id, at P. 219)

Although Byrd leaves little discretion to the trial court other than to compel the enforcement of arbitration agreements, it neither creates the contractual right to arbitration, nor does it remove a person's privilege to waive such a right. What is more, the possibility of waiver is clearly acknowledged in the Federal Arbitration Act. In Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626(1985), for instance, this Court, citing Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25 (1983) stated that:

> The Arbitration Act establishes that, as a matter of federal law, **any doubts concerning the scope of arbitratable issues** should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of **waiver**, delay, or a like defense to arbitrability. [emphasis added]

The statute does not preclude the possibility of waiver but merely increases the burden of proof on the party asserting waiver.

The Fifth Circuit expressly recognized the strong federal policy favoring arbitration, as well as the heavy burden on Respondent to prove waiver under the facts presented, but it nevertheless held in favor of Frye based upon application of well recognized waiver principles. In so holding, the Fifth Circuit rejected the lower court's contrary finding based solely on the "futility" argument and

without regard to the prejudice occasioned by Respondent. It did not find a waiver solely due to Petitioners' delay in moving to compel arbitration as urged. The decision of the Fifth Circuit does not represent a conflict of circuits on the same issue, nor does it in any way conflict with any holding of this Court. Rather, it is wholely consistent with decisions of other circuits addressing comparable factual situations. The apparent conflict among the decisions of other courts, therefore, as the Petitioners would have this Court believe, are based upon factual differences between the Petitioners' cases presented and the factual circumstances of the instant case.

CONCLUSION

For these reasons, Respondent requests that the Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit be denied or, in the alternative, that the Fifth Circuit's decision in this case be affirmed.

DATE: February 7, 1990

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CERTIFICATE OF SERVICE

A true and correct copy of this Response has been sent to Petitioner's counsel of record, William D. Sims, Jr. of Jenkens & Gilchrist, P.C. at 1455 Ross Avenue, Suite 3200, Dallas, Texas 75202.

APPENDIX A

FRYE v. PAINE, WEBBER, JACKSON & CURTIS, INC.

Nancy C. FRYE, Plaintiff-Appellant,

v.

PAINE, WEBBER, JACKSON &
CURTIS, INC., etc., et.al.,
Defendants-Appellees.

No. 88-1871.

United States Court of Appeals,
Fifth Circuit.

July 18, 1989

Investor brought action under federal securities law against brokerage firm. The United States District Court for the Northern District of Texas, A. Joe Fish, Jr., granted firm' s motion to compel arbitration, denied investor's motion for reconsideration and later confirmed arbitrators' decision to dismiss claim and investor appealed. The Court of Appeals, Patrick E. Higginbotham, Circuit Judge, held that brokerage firm waived contractual right to compel arbitration through participation for approximately two and one-half years in judicial proceedings.

Reversed and remanded.

1. Arbitration 23.25

Trial court's finding that party has waived its right to arbitration is subject to de novo review, but factual findings underlying that conclusion may not be overturned unless clearly erroneous.

2. Arbitration 23.3

Despite strong federal policy favoring arbitration, right to arbitrations may be waived.

3. Arbitration 23.4

Both extent of participation by party moving for arbitration in judicial proceedings and delay in moving to compel arbitration are material factors in assessing whether delay was so prejudicial as to constitute waiver of right of arbitration.

4. Exchanges 11(11)

Brokerage firm waived contractual right to arbitration of investor's section 10(b) claim through firm's participation for approximately two and one-half years in judicial proceedings; delay prejudiced investor and furthermore, earlier attempts to compel arbitration would not have been rendered "futile" by doctrine or intertwining which was later rejected in *Byrd*. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Appeal from the United States District Court for the Northern District of Texas.

Before JOLLY, HIGGINBOTHAM, and SMITH, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

Nancy Frye brought suit against Paine Webber Jackson & Curtis Inc., Dean McGowan, Ken George, and Gary Bassett, asserting federal securities and pendent state law claims. After nearly two-and-a-half years, including extensive discovery and an aborted trial, defendants moved to compel arbitration of Frye's claims. Frye opposed this motion, arguing *inter alia* that defendants had waived their right to seek arbitration by participating in judicial proceedings. The district court granted defendant's motion, holding that any attempt to compel arbitration of Frye's claims before the Supreme Court's rejection of the "intertwining" doctrine in *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 84 L.Ed.2D 158 (1985) would have been" futile." The court denied Frye's motion for

reconsideration and later confirmed the arbitrators' decision to dismiss her claims. We reject the district court's conclusion that the doctrine of intertwining rendered earlier attempts to compel arbitration "futile," and hold that defendants waived their right to arbitration by failing to move to compel arbitration during approximately two-and-a-half years of judicial proceedings. We therefore reverse the district court's decision and remand for trial.

I

Frye opened a securities account with Paine Webber in June 1982, signing an agreement which provided that any controversy between the parties would be settled by arbitration. In June 1983, Frye sued Paine Webber and two of its employees, Ken George and Dean McGowan, claiming that she lost over one million dollars in profits due to mismanagement of her account. She asserted violations of section 10(b) of the Securities and Exchange Act of 1934 and various pendent state law claims. She also brought claims under various provisions of the Securities Act of 1933, which she later voluntarily dismissed.

Despite their agreement to arbitrate, defendants never asserted any right to arbitration. Following over a year-and-half of discovery and other pretrial activity, trial commenced before Judge Taylor. At the close of Frye's case-in-chief, Judge Taylor granted the Paine Webber defendants' motion for directed verdict, and the case proceeded against a remaining defendant. Judge Taylor, however, later declared a mistrial and set aside the directed verdict. The case was then transferred to Judge Fish.

In April 1985, defendants demanded arbitration based on the Supreme Court's recent decision in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985) (rejecting doctrine of intertwining and holding that arbitrable pendent claims must be arbitrated). In November 1985, they moved to compel arbitration. Frye opposed the motion, arguing that defendants had waived any right to arbitration by participating fully in discovery and trial without demanding arbitration. The trial court granted defendants' motion, staying all proceedings pending arbitration.[1] The district court ruled that any attempt to compel arbitration of Frye's claims

1. The court stayed Frye's claims against Bassett, which are still pending and are not part of this appeal. The court also stayed Frye's claims against the Paine Webber defendants under Section 12(2) of the Securities Act of 1933. Frye later dismissed those claims voluntarily.

prior to *Byrd* would have been "futile" and that defendants had promptly moved for arbitration after that decision. The court later denied Frye's motion for reconsideration. A panel of arbitrators denied Frye relief. The trial court confirmed the arbitrators' decision and dismissed Frye's claims.

II

On appeal, Frye contends that the trial court erred by compelling arbitration of her claims. She argues that the Paine Webber defendants waived their right to arbitration by ther participation in judicial proceedings.

[1, 2] A trial court's finding that a party has waived its right to arbitration is subject to *de novo* review, but the factual findings underlying that conclusion may not be overturned unless clearly erroneous. *Price v. Drexel Burnham Lambert, Inc.* 791 F.2d 1156, 1159 (5th Cir.1986). Despite the strong federal policy favoring arbitration, the right to arbitration may be waived. *Price*, 791 F.2d at 1158 *(citing Miller Brewing Co. v. Fort Worth Distributing Co., Inc. (FWDC)*, 781 F.2d 494, 497 (5th Cir.1986) and *Sedco, Inc. v. Petroleos Mexicanos Mexican National Oil Co. (Pemex)*, 767 F.2d 1140, 1150 (5th Cir.1985). While the party claiming waiver has a heavy burden, " 'waiver will be found when the party seeking arbitration substantially invokes the judicial process to the detriment or prejudice of the other party.' " *Price*, 791 F.2d at 1158 *(quoting Miller Brewing Co.*, 781 F.2d at 497). "Prejudice to the party opposing arbitration, not prejudice to the party seeking arbitration, is determinative of whether a court should deny arbitration on the basis of waiver." *Price*, 791 F.2d at 1162.

In the instant case, the trial court made no findings as to whether Frye was prejudiced, but held that no waiver had occurred because " 'prior to the *Byrd* decision, a motion to compel arbitration would have been 'futile.' " We later rejected this argument in *Price*, 791 F.2d at 1162.

We do not accept Drexel's contention that such a motion would have been futile, and therefore, that a finding of waiver is unjustified in this case. • • • Drexel's argument is undercut by the *Byrd* decision itself, since the decision would never have reached the Supreme Court but for the defendant's insistence on arbitration in the face of the intertwining doctrine. Moreover, Drexel's futility argument

assumes that the Prices would have objected to arbitration had it been raised *ab initio*.

Id. at 1163. *But see Fisher v. A.G. Becker Paribas Inc.*, 791 F.2d 691, 694-97 (9th Cir.1986) (failure to move to compel arbitration during three-and-a-half years of pretrial activity did not constitute waiver since arbitration agreement was unenforceable prior to *Byrd*). The district court erred by finding that the intertwining doctrine rejected in *Byrd* justified defendants' delay in seeking arbitration of Frye's claims.

[3] "While the mere failue to assert the right of arbitration does not alone translate into a waiver of that right ... such failure does bear on the question of prejedice, and may, along with other considerations, require a court to conclude that waiver has occurred." *Price*, 791 F.2d at 1161. Both delay and the extent of the moving party's participation in judicial proceedings are material factors in assessing a plea of prejudice. *Id.*

In *Price*, we held that plaintiffs had been sufficiently prejudiced by defendant's seventeen-month delay in seeking arbitration, including the time and expense in responding to discovery and a motion for summary judgment, to conclude that defendants had waived their contractual right to arbitration. *Price*, 791 F.2d at 1160-62.[2]

See also Fraser v. Merrill Lynch Pierce, Fenner & Smith, Inc., 817 F.2d 250 (4th Cir.1987) (sufficient prejudice to support waiver where brokerage firm delayed four-and-one-half years before seeking arbitration, two trial dates had passed, and opposing party was required to respond to motion for partial summary judgment, and three motions to dismiss). *But see Rush v. Oppenheimer & Co.* 779 F.2d 885 (2d Cir.1985) (insufficient prejudice to support waiver where securities firm delayed eight months in seeking arbitration, filed answer, moved to dismiss claims, and conducted discovery); *Fisher*, 791 F.2d at 698 (insufficient prejudice to support waiver where brokerage firm delayed three-and-a-half years before seeking arbitration, filed pretrial motions, and engaged in extensive discovery); *Page v. Moseley, Hallgarten, Estabrook & Weeden*, 806 F.2d 291

2. The trial court found that Drexel had "initiated extensive discovery, answered twice, filed motions to dismiss and for summary judgment, filed and obtained two extensions of pre-trial deadlines, all without demanding arbitration." The court concluded that the "mounting attorneys fees," "seventeen month delay," and "disclosure which has resulted from the numerous depositions and production of documents" constituted sufficient prejudice to find that Drexel had waived its right to compel arbitration. 791 F.2d at 1159.

(1st Cir.1986) (insufficient prejudice to support waiver where brokerage firm delayed one year before moving to compel arbitration and only prejudice incurred was time and expense of discovery).

[4] Defendants contend that *Price* is distinguishable because Price had been subjected to the burden of defending against a motion for summary judgment before Drexel moved to compel arbitration. Defendants' attempt to distinguish *Price* is unpersuasive, particularly in ignoring the fact that Frye has incurred the time and expense of an aborted trial.

Frye argues that she was prejudiced by (1) defendants' use of judicial discovery procedures not available in arbitration; (2) substantial attorneys' fees and costs incurred during pretrial proceedings and an aborted trial; (3) the time and expense of defending against defendants' claims for affirmative relief, including a cross-claim and a motion for directed verdict; and (4) the passage of approximately two-and-a-half years time. In light of these undisputed facts, we hold that Frye was sufficiently prejudiced by defendants' participation in discovery and trial to conclude that defendants waived their contractual right to arbitration. We therefore reverse the trial court's decision compelling arbitration of Frye's claims and remand for trial.

REVERSED AND REMANDED

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